

**SUMMARIZED MINUTES
CITY OF SCOTTSDALE AUDIT COMMITTEE
MONDAY, NOVEMBER 13, 2006**



**KIVA CONFERENCE ROOM, FIRST FLOOR, CITY HALL
3939 NORTH DRINKWATER BOULEVARD
SCOTTSDALE, AZ 85251**

MEMBERS PRESENT: Committee Chairman Lane
Committee Member Ecton
Committee Member McCullagh

CITY STAFF PRESENT: Kyla Anderson, Audit Associate
Lisa Blyer, Assistant to Mayor & Council
Craig Clifford, Financial Services General Manager
Gail Crawford, Internal Auditor
Cheryl Dreska, City Auditor
Scott Gray, Aviation Director
Matt Johnson, Acting Airport Administration Coordinator
Dave Jones, Emergency Services Coordinator
Lisa Murphy, Accounting Director
Paula Novacek, Accounting Coordinator
Steve Randall, Assistant Fire Chief

OTHERS PRESENT: Sandy Cronstrom, Cronstrom, Osuch & Company, PC
Carter Smitherman, Cronstrom, Osuch & Company, PC
Ari Cohn, Tribune

CALL TO ORDER/ROLL CALL

Chairman Lane called the Audit Committee meeting to order at 1:31 p.m. Roll call was taken confirming the presence of all Committee Members.

MINUTES - Approval of October 23, 2006, Committee Meeting Minutes

Committee Member Ecton made a motion to approve the October 23, 2006 minutes. Committee Member McCullagh seconded the motion. The minutes were approved by a unanimous vote of three (3) to zero (0).

Agenda Item 1 - Presentation and discussion of the Comprehensive Annual Financial Report and related documents prepared by the City's external auditor for the period ending June 30, 2006

Mr. Carter Smitherman of Cronstrom, Osuch & Company, PC, external auditors for the City, presented the Comprehensive Annual Financial Report, noting the contents of the various sections. Chairman Lane noted that the report states that the financial

statements are the responsibility of City management. He asked Mr. Smitherman whether his firm had obtained a statement signed by City management as to the accuracy of the statements. Mr. Smitherman replied that the Chief Financial Officer signed the letter. Chairman Lane asked about the scope of the audit. Mr. Smitherman explained that his firm uses professional judgment in selecting materiality and significance when giving their opinions. Chairman Lane noted that the report indicates that it is "in conformity with accounting principles generally accepted in the United States of America." Mr. Smitherman confirmed that this formula is used as appropriate since, today, international companies increasingly have opinions based on international GAAP.

Chairman Lane asked about the significance of the bullet point on page 11 which indicates the unreserved fund balance for the general fund at different levels. Mr. Craig Clifford, Financial Services General Manager, explained that the revenue base in the general fund is larger than the City's operating budget base. Revenues are planned conservatively for budget purposes. When the revenues are exceeded, or savings are made, a surplus is accumulated. Staff then plan to transfer this to the capital program in the subsequent year. This fiscal year, the adopted budget takes \$45 million of the \$93 million in the unreserved fund balance, which will help fund one-time capital projects. He further clarified that a portion is set aside per City policy as protection for catastrophic impacts. The \$45 million was transferred into CIP effective July 1. Another portion is set aside for encumbrances of open purchase orders and other liabilities.

Chairman Lane asked whether these funds would not fall into a reserve category. Ms. Lisa Murphy, Accounting Director, explained that, by accounting standards, a reserve is imposed by an external requirement. Funds set aside as a result of City policy cannot be termed reserves, even though they may be allocated to specific purposes.

Chairman Lane noted that the trend is for the unreserved fund balance to increase. However, later in the report there is a statement that expenditures exceeded revenues in FY 05/06, much of which was due to bond or debt accumulation. The report does not give a detailed breakdown. Ms. Murphy advised that on pages 34 and 35 of the Comprehensive Annual Financial Report shows the net use of the proceeds available at the beginning of the year. Mr. Clifford explained that this was for a one-time expenditure. Ms. Murphy added that staff try to time bond issues, which can cause a spike in any given year.

Mr. Smitherman continued by reviewing the Single Audit Act reports, explaining that any government or non-profit entity that receives \$500,000 or more of federally funded expenditures is required to undergo a single audit, which audits compliance to the federal programs concerned. The government auditing standards report describes the scope of the test work performed by the auditors in their audit of internal controls and financial reporting. The auditors found nothing that required reporting. In the auditors' opinion, the City was in compliance with the requirements of the federal programs.

Chairman Lane asked whether Mr. Smitherman's firm reviews the City Auditor's work or places any reliance upon it in performing their tasks. Mr. Smitherman replied that they do not rely on the internal auditors' reports unless they need to ask about a particular matter. Briefly describing the process they follow, he explained that testing is done by sampling. In response to a follow-up question by Chairman Lane, Mr. Smitherman stated that the extent of sampling depends on the nature and volume of what is being sampled.

Chairman Lane asked how the auditors handled the areas noted on the exceptions as internal control issues. He noted that the fuel sales tickets at the Airport were an example of a weakness that is noted. Chairman Lane asked if additional testing was done to determine the extent of the problem. Mr. Smitherman advised that the fuel sale calculation sheets were not always properly completed. The firm did not expand the test work because it was felt that the risk of any material misstatement in that transaction class is relatively low. The exceptions discovered were minor.

Chairman Lane noted that the report indicates the effect of the exception as an internal control weakness. But, in fact, the effect could be a loss of receipts and he wondered why the report simply categorizes it as an internal control weakness. Mr. Smitherman replied that the data would not be distorted to a material extent because there were few occurrences. Chairman Lane remarked that finding exceptions in 7 out of 20 cash receipts tested does not appear minor to him. Mr. Smitherman replied that he had to take into consideration what the miscalculation was in each case. He did not specifically recall each one, but some had missing data. With manual forms one must expect a level of human error. The firm recommends reviewing the calculations on the fuel sale sheets for accuracy. At the Airport, staff check the readings on the fuel pumps regularly. This would detect discrepancies, although he is not aware of the specific procedures for correcting errors that are found.

Chairman Lane opined that the effect is not limited to an internal control weakness. He appreciates the auditors' observations and recommendations. He read the following passage into the record from the report: "A material weakness is a reportable condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements caused by error or fraud in amounts that would be material in relationship to the financial statements being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions."

Mr. Smitherman noted that this is standard language used in accounting and auditing. He assured the Committee that the auditors identified no material weaknesses or reportable conditions.

Chairman Lane noted that much of the audit deals with compliance and is not quantifiable. He asked whether the exposure can be quantified in terms of loss of government grants. Mr. Smitherman stated that if a non compliance issue is found in the course of an audit for which a questionable cost can be calculated, they are required to do so and would report that.

With reference to the finding that purchase orders are not always prepared before goods are ordered, Committee Member Ecton asked whether this happens because of emergencies. It was noted that the auditors found only 2 examples out of the 60 purchase orders they examined. Mr. Clifford advised he has asked the Purchasing Director to ensure that his department pays attention to this. Mr. Smitherman confirmed that the purchase orders were issued after the goods and services were ordered. Mr. Smitherman noted that the City's procedures define "emergency." Although he is not totally familiar with Scottsdale's provisions, this is usually limited to public health and safety. Other departments may make urgent purchases but these would not be defined as emergencies.

Committee Member Ecton opined that this is a great report and appreciates the way that minor issues are addressed in perspective in sidebars. Chairman Lane remarked that the internal auditors now provide a memo to management, which is a similar concept that helps the Committee Members. Mr. Clifford stated that staff strive to make immediate corrections of any weakness that external auditors discover and hope not to have the same finding made the following year. He asks external auditors to pay particular attention to any areas that were noted the previous year. In response to a question by Committee Member Ecton, Mr. Smitherman told the Committee that if they find a high proportion of problems in a sample, their practice is to review what they are doing to be certain that they are testing correctly. If appropriate, the auditors enlarge the scope of the audit. He stressed that these judgment calls are made on a case-by-case basis.

Chairman Lane asked for clarification about the comments regarding reconciliation of grants. Mr. Smitherman explained that because many federal programs reimburse the City for money that the City has already spent, it is a good internal control to reconcile grant applications on a regular basis to be certain that money has been applied for and paid to the City. This is not a federal requirement, rather a question of operational efficiency.

Mr. Smitherman advised the Committee that his firm has a policy of rotating their staff to ensure that annual audits are carried out by different individuals from time to time. Ms. Murphy stated that renewal of the auditors' contract for a further year will be brought forward to City Council on December 11. It is a five-year contract with annual renewal.

Mr. Clifford added that the accounting staff does a stellar job every year pulling together information in a timely fashion. Credit is due to Ms. Novacek, Ms. Murphy, and the other accountants. He noted some of the challenges they had faced. Scottsdale takes pride in usually being the first municipality in Arizona to complete their annual audit. The credit rating agencies complimented the City on this when reviewing the City for the latest bond refunding and bond issue. Standard and Poor's has upgraded Scottsdale's excise tax bond rating to AAA within the last two weeks. Fitch has also just upgraded the City to AAA. These are positive outcomes of all of the hard work performed by City staff, translating into a savings of \$7.2 million in bond refunding.

Agenda Item 2 - Discuss Status of Current Projects

a. Controls Over Tracking Code Enforcement Citations and the Maintenance of the City Abatement Fund

Ms. Cheryl Dreska, City Auditor, reported that she will report to the Committee at a later time regarding controls over the issuance of citations for zoning violations. She will review this area again, taking Committee Member Ecton's comments into consideration.

b. Cab Connection Program

Fieldwork is underway for the Cab Connection program. Risk assessment has been discussed with management. She noted that on this program, there is very little to test. She asked the Audit Committee what kind of survey work they wish staff to carry out. Staff have tried to develop cost comparisons for the cost of Dial-A-Ride, the special transportation services program offered by the County, and the Cab Connection. All

three programs are funded by the City but are provided by different transportation firms. The information pertaining to cost per participant is not readily available. Ms. Dreska inquired whether the Committee would like staff to spend time developing this information.

In reply to a question by Committee Member McCullagh, Ms. Dreska explained that Scottsdale citizens who are over 65 or disabled are qualified for Cab Connection. The City Transportation Department issues vouchers and the individual calls a participating cab company to arrange a ride. This program has been in place since 2000. Chairman Lane confirmed that it was established as a supplementary program for areas of the City that are not serviced by Dial-A-Ride. Ms. Dreska asked how far staff should go in audit work to make a comparison. Staff can test how the vouchers are being used. It may be possible to determine whether residency in Scottsdale was verified before vouchers were issued. There is no information regarding cost comparisons between the three programs.

Chairman Lane noted that since the program started as a supplement to Dial-A-Ride, he felt the Committee would not be looking for a comparative analysis. Committee Member Ecton remarked that if City Council feels uncomfortable, the Transportation Department should be instructed accordingly. Chairman Lane opined that City management or the Transportation Department should be ensuring that the Cab Connection program meets the needs of its users. There may be a need to put procedures in place to document that the vouchers are only given to those who are eligible. There could be a need to determine potential costs. Ms. Dreska agreed that this program has the potential to become an issue. The Transportation Department is investigating this. Ms. Dreska undertook to limit the scope of the audit to the controls on the program.

c. Travel Expenditures

Ms. Dreska reported that the final report has been presented to management for review.

d. Use of the City Procurement Cards

Ms. Dreska reported that the final report has been drafted and will be forwarded to management.

e. Cash Handling Audits

The fourth random cash handling site has been completed and staff will prepare a final report to management wrapping up the results of the four audits. A fifth cash handling audit was performed as part of the WestWorld financial audit.

f. WestWorld Financial Audit

Staff has completed the risk assessment and will be meeting with WestWorld management next week.

Agenda Item 3 - Discuss Development of 2007 Audit Plan

Ms. Dreska stated that meetings are being held with management. She has e-mailed City Council members asking them to advise her of anything they would like to have included in the audit plan. Staff will present the proposed list to the City Manager and bring it back to the Audit Committee, identifying which items were requested by management and which items the audit staff believe should be audited.

PUBLIC COMMENTS – None.

COMMITTEE COMMENTS – None.

ADJOURNMENT

With no further business to discuss, Committee Member Ecton made a motion to adjourn the public meeting of the Audit Committee. Committee Member McCullagh seconded the motion and the motion carried. The Audit Committee meeting was adjourned at 2:25 p.m.

Submitted by

Reviewed by

A/V Tronics, Inc.

Cheryl Dreska
City Auditor